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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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| In the Matter of | ) | |
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| Access Charge Reform | ) | CC Docket No. 96-262 |
| | ) | |
| Price Cap Performance Review for Local Exchange Carriers | ) | CC Docket No. 94-1 |
| | ) | |
| Transport Rate Structure and Pricing | ) | CC Docket No. 91-213 |
| | ) | |
| Usage of the Public Switched Network by Information Service and Internet Providers | ) | CC Docket No. 96-263 |

Comments of the Competition Policy Institute

No. of Copies rec'd 0+16
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January 29, 1996

**Comments of the Competition Policy Institute**

## I. Introduction and Summary

The Competition Policy Institute (CPI) is a non-profit organization that advocates state and federal policies to bring competition to telecommunications and energy markets in ways that benefit consumers. CPI appreciates the opportunity to comment on the Commission's Notice of Proposed Rulemaking in the Matter of Access Charge Reform and the related dockets.

The Commission is correct to undertake the reform of access charges. A system that was appropriate when exchange access service was a monopoly and the Bell Operating Companies could not be competitors in the interexchange market is no longer sustainable following the passage of the Telecommunications Act of 1996. The emergence of competition in all telecommunications markets means that once-acceptable price distortions in the pricing of access services are now fundamentally at odds with national telecommunications policy.

The effects of access charges priced substantially above costs reach both competitors and consumers. The implications for competitors in the interexchange market have been clearly set out by AT&T, MCI and others in communications to the Commission. But the Commission must also recognize at each turn that out-of-line access rates also have both direct and indirect impacts on consumers.

Directly, consumer rates for long distance service are too high, transferring wealth from consumers to producers. Overpriced access causes interexchange service to be overpriced, inhibiting the full use of a major national resource, long distance telephone service. The growth in long distance usage that has accompanied previous cuts in long distance rates demonstrates the huge potential for the additional stimulation of usage that further cuts in long distance rates will bring about. Long distance service is no longer the rarified service it once was ("Operator, I'd like to place a *long distance* call.") but is instead now a natural extension of everyday activities for most people. State boundaries mean nothing to parents calling children; interstate and international boundaries mean nothing today to businesses that deal with customers and suppliers across the country and around the globe. The world of the original AT&T "reach out and touch someone" vignette ads is now the reality for consumers. Commission policy must reflect that reality.

Indirectly, access charges far in excess of costs can hurt consumers by skewing the development of competition in the long distance market and among full-service telecommunications providers. The impending entry of the Regional Bell Operating Companies into the interexchange market means that the Commission does not have the luxury of much time to get access charges in line. Further, the impending competition among full-service providers of local, long distance, wireless and enhanced services also requires that monopoly prices for access services be eliminated. The imputation of access charges into rate floors for long distance service is only a partial, temporary fix to the "rate squeeze" problem within the long distance market. But the next phase of competition, bundled service offerings across markets, cannot develop fully if one competitor can command a supra-competitive level of access charges from another competitor. Consumers have an interest in a fully competitive market involving all telecommunications providers. To the extent that above-cost access charges retard the development of that market, consumers are harmed.

The current system of access charges suffers from four major specific shortcomings: 1) access charges are not based on the economic costs of the service, with the attendant consumer and competitive implications; 2) access charges are not assessed equitably to all users of the LECs' networks; 3) the rate structure used to collect access charges is not economically efficient; and 4) the current system of access charges improperly limits the LECs' ability to respond to competition in the exchange access market. The Commission is correct to reform access charges in a way that addresses each of these shortcomings.

In these comments CPI offers an analysis of these failures of the current access charge system and recommends how the Commission should move access charges to cost. Here is the kernel of CPI's recommendation: **the Commission should order an immediate cut in access rates — a down payment on access charge reform — by re-basing the LEC price caps. The Commission should also set a course to bring access rates to cost over a reasonable transition period using a combination of the prescriptive and market-based approaches outlined in the NPRM.**

Here are CPI's major conclusions and recommendations:

- The Commission should adopt the goal of moving access charges, as applied both to carriers and to end users, to forward-looking economic costs.

- The Commission should adopt policies to move access charges to economic costs steadily over a reasonable transition period.

- Because competition in exchange access service is minimal today, a market-based approach may not lower access charges to economic costs within a reasonable time. The Commission should pursue prescriptive price reductions in tandem with a market-based strategy.

- The Commission should begin access reductions with an order in this review lowering annual access rates by approximately $2 billion.

- The Commission should refine its "market-based" triggers and the associated flexibility. The basic concept is sound; however, the timing is out of phase in some cases.

- The LECs should be granted pricing flexibility proportionate to the level of actual competition in the exchange access market. Commission rules should limit the ability of LECs to shift lost revenues to other services within a price cap basket. Individual case basis contract pricing should not be permitted until there is substantial actual competition.

- The Commission should adopt several rate structure reforms outlined in the Notice. The Commission should re-classify certain fixed costs of local switching from variable to fixed and permit their recovery through a combination of fixed and usage-sensitive charges. The call set-up charge proposal is justified and should be permitted on an optional basis, assuming measuring costs are reasonable. Similarly, time-of-use access prices would be appropriate if the measurement is feasible and its costs are reasonable.

- The Commission should adopt a hybrid rate design to apportion responsibility for common line costs to all users of the common line and move away from charges based on minutes of use.

- The Commission should conclude that all interstate users of the common loop, including wireless providers and enhanced service providers, should contribute to the recovery of common loop costs.

## II. Overview of Access Charges

Simply put, access charges are a device to recover a portion of the costs of the public switched network of the incumbent Local Exchange Companies. Access charges were an expedient method to accommodate the emergence of competitive long distance carriers purchasing connections to local service subsidiaries of the integrated AT&T system. The ENFIA tariffs, established in 1979, were the precursors to today's system of access charges. This scheme was extended after divestiture to include AT&T as a purchaser of access from the newly divested operating companies. For competitive consistency, interexchange carriers were assessed access charges which were, in the aggregate, designed to recover the same contribution that ENFIA tariffs and settlements had provided to the local exchange companies.

Access charges were never based on economic costs. They were, at the beginning, designed to continue a system of revenue settlements between subsidiaries of AT&T and were not designed to be a subsidy of any particular set of services. The description of access charges as having been designed to subsidize local exchange service is not accurate. (Eventually, cost elements that were explicitly linked to universal service subsidies, e.g., DEM weighting, High Cost Support, and LTS, were added to access charges.)

Access charges are composed of two distinct categories of costs: i) directly assignable costs such as switching costs and transport facilities, and ii) shared costs that cannot be directly assigned, such as loop costs. The justification for recovery of common costs in access charges is this: the cost of facilities used jointly in the provision of multiple services equitably should be borne jointly by the users of those facilities. This is a useful principle even if it does not provide an method for deciding what the exact apportionment of the costs should be. At each stage of telecommunications regulation, from settlements, to ENFIA tariffs and today's access charges, this principle has been invoked. It has even been codified in the Communications Act with the requirement that the Commission and the States adopt cost allocation methods to ensure that prices for universal service "bear no more than a reasonable share of the joint and common costs of facilities used to provide those services"[1]

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[1]Section 254(k) of the Communications Act.

While this discussion of access charges is elemental, it illustrates several points that the Commission should keep in mind when considering proposals for access charge reform. CPI recommends that the Commission adhere to the following principles as it proceeds with access charge reform:

- Because of realignment of telecommunications providers, access charges have evolved from an inter-sector payment to an inter-competitor payment. Like other inter-carrier transactions, access charges should be priced at forward-looking economic costs. This is the same logic the Commission applied to the pricing of unbundled network elements in its Interconnection Order.

- All users of common network facilities should contribute to the recovery of these costs. There is no logical basis for exempting any significant interstate users of the LECs' public switched network from access charges priced at economic cost levels.

- Cost allocation and rate design should assign and recover access costs in a rational and economically efficient manner.

- Consumers, as well as carriers, should benefit from reductions in access charges. In particular, any reductions in the amount of common line costs recovered from interstate users should be flowed through to the Subscriber Line Charge as well as the Carrier Common Line Charge or its successor.

## III. The Two Approaches to Access Charge Reform: Market-Based versus Prescriptive

In the Notice, the Commission asks for comments on two distinct, but complementary, approaches to reducing access charges. The first approach, the market-based approach, relies chiefly on emerging competition in the exchange access market to create sufficient pressure to bring access prices to cost. Under this approach, the FCC proposes to stimulate competition in the access market by granting flexibility to the ILECs in pricing access while continuing to remove market barriers to competition in the market. In some ways, this market-based approach generally describes the process underway in state jurisdictions with respect to local exchange service: stepped deregulation of LECs is tied to the development of competition for local exchange service.

The second approach, dubbed the prescriptive approach, would reduce access charges to economic levels by action of federal regulation. The Commission suggests several possible methods to implement the prescriptive approach, ranging from i) immediate re-basing of price cap bands to set access prices at economic costs to ii) a phased approach in which price caps are reduced progressively over a transition period, eliminating any gap between current levels and economic costs.

Before discussing the merits of each approach, we note an obvious but unstated conclusion: the market-based "approach" will necessarily accompany any other steps the Commission takes to reduce access charges through prescriptive means. That is, market pressures will continue to build in the market for exchange access service, for several reasons. The ability of ILECs to command supra-competitive prices for access services will become progressively more limited as that market becomes competitive. The real issue facing the Commission is this "How long will this take and how much additional pressure should be applied to this process using the prescriptive approach?"

**The Market-based Approach.** *As a theoretical matter*, the market-based approach offers advantages over a regulatory approach.[2] Under this approach, competition, not cost studies, determines the price of access services. Entry by competitors is efficient; innovations are driven by demand, not by the prodding of regulators and are not subject to regulatory approval. The correct amount of capital is invested; the correct amount and type of access services is supplied.

These are, of course, the same advantages that competition offers over regulation more generally. It is nearly axiomatic that regulation is always a second-best approach compared to competition. And, assuming that competition in the exchange access market is *feasible*, competition will eventually move prices in this market to their correct economic level.

But, regarding the market-based approach for access reform at this time, CPI feels compelled to point out the emperor is not fully clothed. While limited competition has developed in some sectors of the access market, the total amount of competition on a national basis, especially for

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[2]We discuss separately the general "market-based approach" and the specific proposal outlined by the Commission in the Notice.

switched access, is so small that much of the discussion about the market-based approach is an academic exercise. In fact, the Commission's Notice in this section has a distinctly academic cast to it, speculating as it does about the potential that competition will develop in this market and about elasticity of supply, barriers to entry, etc. The reader, and the observer of the switched access marketplace, cannot help but conclude that the exchange access marketplace may be many years from being competitive. (Elsewhere in the Notice, the Commission seems to share these doubts: in Section I the Commission states that the goal of access charge reform is to "end up with access charge rate structures that a competitive market would produce."[3] This is distinct from the goal of actually having a competitive access market.)

We may assume that, somewhere in the future, the exchange access market will be competitive. Under this assumption, the prices charged for access, in this long run, will approach the long run incremental costs. The question is this: how long may we wait? How quickly will this method bring access charges to cost?

Thus, as an academic matter, the market-based approach is preferable to a prescriptive approach, if each has an equal chance of success. But without more information, we cannot conclude that these two approaches have equal chances of success. CPI is confident of the Commission's ability to require the ILECs to lower access charges to levels approximating economic costs within a reasonable timeframe. We are far less confident that market forces will reduce prices to

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[3]NPRM, para. 13.

economic costs anytime soon.

Even though there is little evidence of competition in the switched access market at the present time, there is reason to think that competitive pressures may begin to develop. The principal reason for such hope is the Commission's decision to require that unbundled network elements (UNEs) be priced at economic levels. CPI also supports the Commission's tentative conclusion that unbundled network elements should be excluded from the Part 69 access charge regime, regardless of whether the carrier that purchases them uses them for local exchange services or exchange access services.[4] As new local market entrants begin to self-provide exchange access through the use of unbundled network elements, there will be pressure on the incumbent access providers to reduce access rates to similar levels, at least for originating access services. This scenario was outlined in the Commission's Notice.[5] Additional pressure will come from facilities-based providers such as cable companies as these new entrants begin to use alternative facilities to complete connections between end-users and interexchange carriers, bypassing entirely the loops of the incumbent LEC.

CPI agrees that growth in the use of TELRIC-priced unbundled network elements will put pressure on LEC access charges. By winning the local customer, an IXC entering the local exchange market will be able to use TELRIC-priced loops, switching and transport to connect

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[4]NPRM, Para. 54.

[5]NPRM, Para. 8 and 54.

their local customers to their long distance network. However, there are obvious limits to this effect.

First, relative to the package of services that a consumer is presumed to purchase, the access market is a derived market. Consumers don't purchase access directly and won't select a local carrier on the basis of its cost of access--this will be only one component. Second, other reforms contemplated in this NPRM may dilute the pressure on the LEC to reduce access prices. For example, converting the per-minute CCL charge to a flat charge will lessen the incentive and the effect of "bypassing" access charges through unbundled network elements for large toll users.

CPI also notes that it is not certain that unbundled network elements will be priced at economic costs in all cases. While the majority of states have followed the FCC's lead in setting unbundled network elements at TELRIC levels, some of those arbitration agreements have been appealed on this issue. Without the force of an FCC interconnection order on the pricing issue, state commission actions may be overturned in some cases. Under the best assumptions, there will be delay and continued uncertainty. On another front, the Arkansas General Assembly seems very likely to pass legislation requiring that the price of unbundled network elements for Southwestern Bell be based on "actual" costs, a term that has become a euphemism for "embedded" costs. It is far from certain that unbundled network elements will provide the pressure needed to bring access prices down expeditiously.

Finally, to illustrate the enormity of the task facing new entrants, consider the following arithmetic fact: to win the business of just 30% of the lines served by incumbent local exchange carriers, CLECs will need to add 42,000 new customer lines every business day for the next five years.[6]

**The Prescriptive Approach.** The principal advantage offered by the prescriptive approach is the confidence that it will succeed in reducing access rates to a level approximating economic costs within a reasonable timeframe. This is a considerable advantage, especially in view of the flux in the markets created by the Telecommunications Act of 1996. The likelihood is that multiple carriers, including LECs, will offer competing bundles of services. The distortions created by access charges priced substantially above costs will confer an unfair advantage to the LECs and will distort choices providers make in assembling these service packages and consumers make in demanding them.

There are also some disadvantages to the prescriptive approach. First of all, it may not produce particularly accurate results. The market will identify the efficient price for the elements of access service through the crucible of competition. Regulation must rely on cost studies. The current debates about cost allocations in cost proxy models reveal that we do not know the exact results a competitive marketplace will produce for prices and rate structures. In addition, the Commission correctly points out that there are substantial administrative costs, for both providers and regulators, involved in implementing the regulatory approach.

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[6]This estimate assumes 150 million access lines in 1997 and a 4% growth rate in access lines.

Notwithstanding these weaknesses in the regulatory approach, CPI is convinced that the Commission's approach should have a prescriptive component, at least at the beginning of the process of access charge reform. As we discuss below, the Commission should take the opportunity to launch access charge reform by a prescriptive rate reduction, using the record in its Price Cap proceeding. Prices for access are likely so far above economic costs that the Commission can be confident that any lack of accuracy which might ultimately afflict cost studies will not be relevant now. CPI believes that it will be possible to phase-out the prescriptive approach as market forces take hold in this market; determining the correct balance of the two approaches is the Commission's exact challenge.

## IV. Rate Structure Issues

### A. Recovery of the Carrier Portion of Common Line Costs

CPI supports the notion that the non-traffic sensitive costs of subscribers' lines should be collected on a non-traffic sensitive basis. In particular, CPI supports the Commission's tentative conclusion that the Carrier Common Line (CCL) charge should be collected on a flat-rate basis rather than on a per-minute basis. In its Recommended Decision, the State-Federal Joint Board on Universal Service made a similar recommendation. CPI also agrees that the interexchange carriers should bear a portion of the cost of the loop. We disagree, however, with the notion that the IXCs should be the only providers who contribute to the recovery of the common line costs. All providers of telecommunications services that use the local loop should share in the recovery of these costs, including "dial-around" IXCs, local competitors, cellular and other wireless carriers, and Internet access and other enhanced service providers.

In particular, the FCC suggests that one possible alternative to recovering the NTS costs on a traffic-sensitive basis is to assess a charge against each customer's presubscribed interexchange carrier (PIC).[7] Presumably, the Commission believes that IXCs should contribute to the costs of the customer's loop because IXCs "use" the local loop in originating and terminating calls. As the Commission notes, however, end user customers also use IXCs other than their presubscribed IXC to make calls by "dialing around" the PIC. Since these "dial-around" carriers also originate and terminate calls using the local loop, these dial-around carriers should also be assessed a portion of the cost of the local loop. We discuss a possible approach to this issue below. Similarly, local wireline competitors, wireless carriers and enhanced services providers originate and terminate traffic over the local loop, so they should also contribute to these costs. To restrict the recovery of these charges to the PIC would discriminate against certain IXCs and in favor of dial-around IXCs, wireless and enhanced services providers.[8] For these reasons, the Commission should require <u>all</u> providers who use the local loop to support the interstate portion

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[7]NPRM, Para. 60.

[8]As noted, CPI agrees with the notion that, since the costs of the loop are not traffic-sensitive, the charges for use of the loop should not be collected on a traffic-sensitive basis. It is not necessary to collect these charges from each provider in exactly the same manner, as long as each provider contributes to the common line costs and as long as each provider is charged on a flat-rate basis. For example, the Commission could assign each category of provider responsibility for a certain dollar amount of costs, and establish a different means of collecting these costs for providers within each category. The Commission could then require presubscribed IXCs to pay a flat charge for each PIC, require "dial-around" IXCs to pay a bulk billing charge based on aggregate minutes of use, and require ESPs to pay a charge based upon the number of ports they purchase from the ILEC.

of the fixed costs of that loop that is not recovered from the SLC.

In our presentation to the Commission[9], CPI suggested several alternatives for allocating common line costs among carriers that do not rely on minutes-of-use in their design or operation. These methods include:

Bulk Billing — allocation of access costs based on aggregate minutes of use or aggregate revenues.

Presubscribed Lines — For IXCs, an allocation based on the number of customers that have presubscribed to the carrier.

Capacity Charge — A charge based upon the number and type of trunks that carriers purchase from the ILECs. A trunk-based charge would vary based on the amount of capacity ordered by the carrier, as an estimate of a carrier's ability to use loops to originate and terminate traffic.

Trunk Port Charge — A charge to each carrier based upon the number of ports at the local switch.

Trunk and Line Port Charge — A variation of the Trunk Port Charge that bases the charge on number of trunk-side ports and the number of line-side ports.

Hybrid Rate Structures — Allocation of costs on some common basis to each class of users (CMRS, IXCs, ESPs, etc.) and then the use of a consistent allocator among individual providers

[9]"Ideas for Access Charge Reform," *ex parte* presentation of the Competition Policy Institute, December 5, 1996.

within the class of users.

Several telecommunications have advocated the use of presubscribed lines to allocate common line costs among the IXCs. The advantage of this allocator is that it matches the allocator to the bulk of the costs being allocated--mainly loops. However, allocating this pot of costs can also be viewed as the problem of apportioning a lump of non-traffic-sensitive costs (aggregate loops) fairly to all telecommunications providers, not just IXCs, and not just on the basis of the number of loops over which traffic can be originated for a given IXC. In our submission, CPI noted that the "presubscribed lines" allocator suffers from the fault that it does not capture activity by IXCs whose customers reach them through "dial-around" methods. In other words, if presubscription is used as an allocator, IXCs that encourage customers to reach them through 10XXX access pay relatively too little for the use of the public switched network of the LECs.

If the Commission apportions carrier common line costs among IXCs on the basis of presubscribed lines, CPI suggests that a modification be made. There should be some contribution to carrier common line costs paid by IXCs to the extent they use 10XXX access. We suggest this could be accomplished by identifying the total fraction of interexchange traffic (based on minutes of use) that originates as "dial around" calls. This fraction is applied to total common line costs to create a "dial-around" revenue pool which is charged to IXCs in proportion to their fraction of total "dial-around" activity. The basis for this assignment could be any of the methods listed above (except, of course, presubscribed lines). In this way, all IXCs would contribute fairly to the access revenue requirement, regardless of their relative use of "dial around" access.

B. Recovery of the End User Common Line Costs

**SLC Reductions.** CPI supports the recommendation of the Universal Service Joint Board to reduce the End User Common Line Charge (EUCL or Subscriber Line Charge or SLC) by an amount to reflect the removal of Long Term Support costs and certain coin phone costs from common line costs. We renew that support in these Comments and recommend further that any additional reductions the level of common line costs that LECs are allowed to recover be applied to the Subscriber Line Charges in the same proportion as reductions to the Carrier Common Line Charge or its successors.

**SLC Caps.** CPI opposes the removal of the SLC cap for residential lines beyond the first line and for multi-line businesses. The SLC cap of $3.50/$6.00 was essentially a political compromise that determined the split of common line cost recovery between local customers and the interexchange carriers (and their customers). It is not necessary to re-open that debate by allocating the "full interstate allocation" to the end user in the case of additional residential lines or to exceed the $6.00 cap for multi-line business users. The Commission should not raise SLC caps until the LECs demonstrate that the underlying costs are necessary and prudent. In particular, SLC caps should not be rising at a time when access charges generally are moving down. A possible exception is discussed below, where we offer the compromise of removing the SLC cap to compute the charge for each of the two loops used to provide Primary Rate Interface (PRI) ISDN.

**SLCs for Derived Channels (ISDN).** The Commission seeks comment on the application of the SLC to derived channels such as ISDN. In the Notice, the Commission provided data from the ISDN SLC Notice of Proposed Rulemaking that show the non-traffic-sensitive investment associated with Basic Rate Interface (BRI) ISDN is 1.24 times the investment for analog service. For PRI ISDN the ratio is approximately 10.5 times the investment for analog service. CPI agrees with the commenters in the ISDN SLC docket that these investment ratios could fairly be used to compute the appropriate SLC for each service.[10]

C. Pricing of Local Switching

CPI supports the use of improved methods for aligning prices of local switching with its costs. The Commission should permit access providers to develop, on an optional basis, an access rate element to recover costs of call setup and to develop time of day access rates. It is not clear how much the costs of measurement will intrude on the decision to institute these elements. However, given the growth in "bursty" uses of the network (e.g., credit card swipes) and possible higher percentages of non-completed calls (automatic re-dialers in modems, cell phones and some desk sets) it may be appropriate to begin to account for these costs separately. It is reasonable to permit access providers to decide whether to institute such refinements to the rate structure: the Commission should permit carriers to file a call setup access element, but not

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[10]In the alternative, we suggest the following compromise: consistent with current practice, a single SLC should be applied to Basic Rate Interface ISDN arrangements. For PRI ISDN, two SLCs would be applied, each priced at the full interstate allocation of NTS costs per loop. We acknowledge this is an exception to the discussion above about the compromise surrounding SLC caps. On the other hand, PRI ISDN was probably not sufficiently available in 1985 to have been considered in the SLC decision.

require it. Similarly, switching based on time-of-day (to reflect switch congestion and allocate costs on a peak load basis) has a sound economic basis and should be permitted. Of course, CPI assumes that these rate structure changes do not affect, by themselves, the total revenue collected, but merely collect the same revenues through more refined tariff elements.

The Commission has also identified the fact that certain switching costs (e.g., line termination cards) are fixed in nature and may not properly be collected as traffic sensitive costs. CPI supports the change to a two-part local switching tariff with fixed and variable elements.

D. The Transport Interconnection Charge (TIC)

CPI questions the Commission's reasoning in allowing the ILECs to continue to collect the Transport Interconnection Charge without knowing what these costs are intended to recover. The ILECs should bear the burden of demonstrating what costs are recovered by the TIC and how those costs should be allocated, if proper. Indeed, unless the ILEC can demonstrate that the TIC properly recovers certain transport costs, it is not certain that these costs actually exist, let alone whether they are prudently incurred. Until the ILECs make this demonstration, the Commission should not allow them to collect the TIC at all, or should at least phase out the TIC as soon as possible.

## V. Recommendations

### A. The Commission Should Find That Access Charges Should Properly Be Priced at Forward Looking Economic Costs.

In its Interconnection Order, the Commission concluded that interconnection and unbundled network elements should be priced at long run economic costs and established the TELRIC methodology for setting such prices. CPI asserts that the same logic applies to the price of access services provided by LECs to other interconnecting telecommunications providers, including interexchange carriers, CRMS providers, enhanced service providers, and others. Access charges should be priced at TSLRIC levels, including a reasonable share of joint and common costs.

In the Interconnection Order, the Commission concluded that new competitors in the local exchange market should be able to purchase unbundled network elements at the same incremental cost experienced by the incumbent. A very close parallel applies in the case of access services: the LEC access provider (in the case of the BOCs) may soon be entering the interexchange market. The bottleneck facility controlled by the LEC will be required by its long distance competitor to compete in another service. Applying the same logic as was used in the Interconnection Order, the price of access should be set at TSLRIC levels to ensure fair competition and efficient entry in these markets.

A similar version of the same analogy concerns the access purchaser and the access provider as competitors in another, less distinct, market: bundled telecommunications services. Once again, the access service is an indispensable component of the package of services for each competitor. In the absence of competitive suppliers of this access service, one competitor should not have the advantage over the other by being able to sell the input at prices above economic costs.

In summary, TELRIC or TSLRIC pricing provides several substantial advantages:

- TSLRIC prices will induce new entrants into the exchange access market to make economically correct decisions;
- TSLRIC pricing will prevent price squeezes and keep competition between access purchasers and access providers fair in the other markets in which they compete;
- Prices based on embedded costs will not be efficient, leading consumers to demand the "wrong" level of long distance services.

CPI acknowledges the difficulty in moving immediately to TSLRIC price levels for exchange access services and we describe a transition plan below. A flash-cut move to economic costs could cause disruption to the emerging competitors in the exchange access market and might cause substantial dislocation for the LECs that provide the service. We also acknowledge that legal appeals and political effects might accompany an immediate reduction in access prices. But the Commission should not permit the difficulty in moving prices to economic costs to dissuade it from affirming the correctness of the principle or from adopting the goal of moving prices to that level through a combination of tactics.

## B. The Commission Should Begin Reductions in Access Charges with a "Down Payment"

We assume, as the Commission should, that access charges are priced considerably above economic costs. There is healthy debate about whether today's rates exceed economic costs by 100% or 500%. CPI suggests that the Commission should draw this obvious conclusion from the debate: access charges can be substantially reduced without running into any party's margin. The Commission could safely conclude that access charges are overpriced, even if, at this time, the exact level of excess is not decided.

CPI recommends that the Commission exercise its unquestioned jurisdiction to reduce access charge price caps for price-cap-regulated LECs by an aggregate amount of approximately $2 billion. CPI is confident that such a reduction can be justified on the basis of the record before the Commission in the Price Cap review. In particular, the Commission can take the following steps to reduce access prices: 1) re-basing price cap indices using a current cost of capital; 2) increasing the Consumer Productivity Dividend; and 3) increasing the productivity offset to a level that would align the expected rate of return with market levels; and 4) instituting a "policy-based" re-initialization.[11]

CPI recommends that the Commission craft this reduction to be a "down payment" that starts the

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[11]CPI recommends that this reduction be reflected equally in lower carrier access rates <u>and</u> lower subscriber access rates. Insofar as possible, the Commission should target the reduction to the terminating access charge in the CCL, arguably the element that is least susceptible to competitive pressure.

process of access charge reduction. There are several benefits of this approach: 1) consumers will see benefits from lower long distance rates; 2) lower access rates will have a salutary effect on competition in the long distance market and the market for bundled telecommunications services; 3) an up-front rate reduction will underscore the Commission's commitment to access charge reductions; 4) an initial reduction will permit the Commission to turn to the market-based approach for further reductions.

There is ample logic and support for the Commission to take this action. First, the Commission is charged with maintaining rates at just and reasonable levels. To accomplish this responsibility, the Commission should consider market returns. While some commenters will try to obscure this fact, in the long-run, returns on capital are equal to market levels in a competitive market. The Commission should ignore claims that examining the earned return of a regulated company is a throwback to the rate-of-return methodology. Instead, the Commission should affirm the correctness of these economic facts: a firm in a competitive market can depart periodically from market returns because of innovation that distinguishes it from the other market players; but that distinction is typically short-lived as competitors enter the market and employ similar efficiencies to drive the return back down to a market level.

Nor should the Commission be persuaded that a "prescriptive" adjustment downward of rates to a market return should suppress the drive for innovation. There are evidently market barriers that have, to this point, limited competition in the exchange access market. CPI asserts that the ability of incumbents in this market to sustain rates of return above market levels is more likely